

Message Text

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AMEMBASSY JIDDA

C O N F I D E N T I A L EC BRUSSELS 02319

E.O. 11652: GDS

TAGS: EFIN, EEC

SUBJECT: EC COMMISSION SETS ECONOMIC POLICY CONDITIONS FOR ITALY

REF: (A) EC BRUSSELS 2070 (NOTAL), (B) EC BRUSSELS 2066,
(C) 75 EC BRUSSELS 10804 (NOTAL)

1. BEGIN SUMMARY: EC COMMISSION OFFICIALS PLAN ON A MODEST TIGHTENING OF 1976 ECONOMIC POLICY CONDITIONS FOR ITALY SHOULD THE EC GO AHEAD WITH

A COMMON BORROWING FOR ITALY. THESE CONDITIONS ARE CONSIDERED RESTRICTIVE BECAUSE OF ADDED INFLATIONARY PRESSURES COMING FROM THE DEPRECIATION OF THE LIARA AND EXPECTED WAGE INCREASES. OFFICIALS HERE ARE CONCERNED OVER THE GOI'S ABILITY TO ADHERE TO THESE CONDITIONS AND PLAN TO MONITOR ITS PERFORMANCE CLOSELY. AN INCREASE IN EXPORTS IS EXPECTED TO STIMULATE THE ECONOMY, BUT IF THIS FAILS TO MATERIALIZE, THE GOI MAY HAVE TO TAKE FURTHER EXPANSIONARY MEASURES IN THE SECOND HALF OF 1976. COMMISSION OFFICIALS EXPECT THE MARCH 15 FINANCE COUNCIL TO GIVE FINAL APPROVAL TO A COMMON BORROWING FOR ITALY AND IRELAND. THESE FUNDS WILL BE RAISED IN EUROPEAN MARKETS AND WILL INCLUDE A COMBINATION OF FIXED AND VARIABLE INTEREST RATES. END SUMMARY.

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2. EC COMMISSION OFFICIALS TELL US THAT THE EC CANNOT EXPECT THE GOI TO APPLY SEVERE ECONOMIC RESTRAINTS AT THIS TIME BECAUSE OF THE GOI'S VULNERABLE POLITICAL SITUATION. THE MONETARY COMMITTEE'S REQUEST FOR A STRINGENT STABILIZATION PROGRAM (REFS A AND B) IS NOT POLITICALLY REALISTIC. INSTEAD, THE COMMISSION HAS PROPOSED TO THE GOI A MODERATE TIGHTENING IN THE CONDITIONS WHICH THE GOI AGREED TO LAST NOVEMBER UNDER THE EC MEDIUM-TERM CREDIT TO ITALY (SEE REF C). COMMISSION OFFICIALS ADD, HOWEVER, THAT THESE CONDITIONS WILL IMPOSE SIGNIFICANT RESTRAINTS BECAUSE OF THE INFLATIONARY PRESSURES RESULTING FROM THE SHARP DEPRECIATION OF THE LIRA.

3. THE COMMISSION HAS PROPOSED REVISING DOWNWARD THE FOLLOWING POLICY CONDITIONS FOR 1976: (1) THE GROWTH OF TOTAL LENDING WOULD BE LIMITED TO 29.5 TRILLION LIRA COMPARED TO AN ORIGINAL TARGET OF 31 TRILLION FOR THE 12-MONTH PERIOD ENDING MARCH 31, 1977; TOTAL LENDING INCLUDES FINANCING OF TREASURY DEFICITS, LOANS GRANTED BY ITALIAN COMMERCIAL BANKS AND SPECIALIZED FINANCIAL INSTITUTIONS AND BONDS ISSUED BY NON-TREASURY PUBLIC AUTHORITIES; (2) THE DEFICIT ON TREASURY TRANSACTIONS MUST NOT EXCEED 13.8 TRILLION LIRA COMPARED TO AN ORIGINAL TARGET OF 14.8 TRILLION; AND (3) CENTRAL BANK FINANCING OF THE DEFICIT ON TREASURY TRANSACTIONS SHOULD NOT EXCEED 5.2 TRILLION LIRA COMPARED TO AN ORIGINAL TARGET OF 14.8 TRILLION; AND (3) CENTRAL BANK FINANCING OF THE DEFICIT ON TREASURY TRANSACTIONS SHOULD NOT EXCEED 5.2 TRILLION LIRA COMPARED TO AN ORIGINAL TARGET OF 5.7 TRILLION. COMMISSION OFFICIALS BELIEVE GOI AUTHORITIES WILL ACCEPT THESE REVISED CONDITIONS. THEY WILL BE PROPOSED TO THE MARCH 15 FINANCE COUNCIL FOR FORMAL ADOPTION, IF AT THAT TIME AN EC COMMON LOAN IS APPROVED FOR ITALY.

4. COMMISSION OFFICIALS ARE CONCERNED OVER THE GOI'S ABILITY TO MEET THESE TARGETS. THEY EXPECT THAT THERE WILL BE A PICKUP IN THE VOLUME OF ITALIAN EXPORTS IN THE NEXT SIX MONTHS, PERHAPS AS MUCH AS 10 PERCENT ON AN ANNUAL BASIS. SUCH A PICKUP WOULD HELP STIMULATE THE ECONOMY AND PUT IT ON THE ROAD TO FULL RECOVERY. HOWEVER, SHOULD EXPORTS FAIL TO

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INCREASE, COMMISSION OFFICIALS SAY THAT THEY WOULD TAKE A SYMPATHETIC ATTITUDE TOWARD ADDITIONAL EXPANSIONARY MEASURES, EVEN IF THESE SHOULD CAUSE THE GOI TO EXCEED THE AGREED-UPON CONDITIONS. IN THE INTERIM, HOWEVER, THE COMMISSION INTENDS TO MONITOR CLOSELY GOI ECONOMIC PERFORMANCE TO INSURE THAT IT ADHERES TO THE TARGETS.

5. COMMISSION OFFICIALS AGREE WITH THE MONETARY COMMITTEE'S

SUGGESTION THAT THE GOI SHOULD ADOPT AN INCOMES POLICY TO HELP MODERATE WAGE DEMANDS. SUCH A REQUIREMENT, HOWEVER, CANNOT BE IMPOSED. THEY SAY THAT THE GOI AUTHORITIES DO NOT BELIEVE IT IS FEASIBLE TO ADOPT AN INCOMES POLICY IN THE CURRENT POLITICAL ENVIRONMENT. THE BEST THE GOI CAN DO IS ASK LABOR TO MODERATE ITS DEMANDS AND POINT OUT THAT EXCESSIVE WAGE INCREASES WILL ONLY LEAD TO FURTHER RESTRAINTS IN THE FUTURE. COMMISSION OFFICIALS SAY NOMINAL WAGE SETTLEMENTS ARE TENDING TOWARD A 5-6 PERCENT INCREASE, IN ADDITION TO THE AUTOMATIC ADJUSTMENT OF WAGES TO KEEP UP WITH THE RISE IN PRICES. IF THIS PATTERN CONTINUES, NOMINAL WAGES WILL RISE 18-21 PERCENT THIS YEAR. THE COST-PUSH EFFECT OF THIS INCREASE WILL SUSTAIN THE RISE IN PRICES AND SQUEEZE BUSINESS PROFITS, WHICH COULD UNDERCUT CONFIDENCE AND DISCOURAGE INCREASED PRIVATE INVESTMENT. IN SUM, OFFICIALS LOOK TOWARD EXPORT-LED GROWTH TO PICK UP THE SLUGGISH ECONOMY.

6. EC LOAN: COMMISSION OFFICIALS EXPECT THE MARCH 15 FINANCE COUNCIL TO APPROVE BORROWINGS FOR ITALY AND IRELAND ON EUROPEAN CAPITAL MARKETS TOTALLING \$1.3 BILLION. THEY EXPECT TO HAVE COMMITMENTS FOR THE PLACEMENT OF THE FULL AMOUNT. PART OF THESE PLACEMENTS WILL HAVE VARIABLE INTEREST RATES. THIS MAY CAUSE PROBLEMS BUT THE COUNCIL IS EXPECTED TO GO ALONG WITH A PACKAGE INCLUDING BOTH FIXED AND VARIABLE INTEREST RATES. COMMISSION OFFICIALS CONFIRM THAT THEY HAVE DECIDED TO DROP SAUDI ARABIA AS A SOURCE OF THE FUNDS FOR IRELAND. THEY ADD THAT THEY DO NOT PLAN ON USING THE EC COMMON BORROWING FACILITY FOR A DIRECT PLACEMENT IN THE US MARKET AT THIS TIME, BECUASE IT WOULD TAKE TOO LONG TO MEET REQUIREMENTS OF THE SEC. ONCE THE FACILITY IS WELL ESTABLISHED, THE EC MIGHT CONSIDER A US PLACEMENT BY THE EC COMMON BORROWING FACILITY.
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